

Statement of Kenneth M. Donohue  
Inspector General  
Department of Housing and Urban Development  
Before the  
Committee on Government Reform  
Subcommittee on Government Management,  
Finance and Accountability  
United States House of Representatives  
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Good Afternoon Chairman Platts, Ranking Member Towns and Members of the Subcommittee. Thank you for the opportunity to address the Subcommittee on the important topic of the role of Inspectors General in preventing waste, fraud and abuse in the Gulf coast areas.

Once again, an area of our nation has been hit by an unexpected disaster that has taxed emergency services and redirected federal Inspectors General toward assisting local government and overseeing the expenditure of a large amount of federal money. Congress estimates that damage to residential structures in the affected Gulf Coast region will range from \$17 to \$33 billion.

Pre-Existing HUD Programs:

To put the magnitude of the devastation into perspective from a HUD programmatic standpoint, in the Presidentially-Declared Disaster Areas, HUD's Federal Housing Administration (FHA) Single-Family Insurance Fund insured more than 328,000 mortgages having an unpaid principal balance of \$23 billion. FHA's multifamily program in the disaster area insured 859 properties comprised of 116,000 units with an unpaid principal balance of \$3 billion. The Hurricanes affected 79 Ginnie Mae (Government National Mortgage Association) issuers, causing

Ginnie Mae to assess a \$500 million risk of loss to its investment portfolio.

Moreover, assets of HUD's public housing authorities (PHA) program suffered tremendous damage, affecting housing of almost 120,000 families. The photographs exhibited are like many shown in the media following the hurricanes however, in this instance, they document damage to HUD-funded housing programs. The Housing Authority of New Orleans initially received a \$21.8 million grant from the Public Housing Capital Fund reserve for the cost and repair of its public housing inventory pending a full damage assessment.

HUD's Office of Community Planning and Development (CPD) plans to reprogram existing funds of \$380 million for the disaster areas. To expedite the process, CPD issued numerous waivers to streamline its grant programs including HOME Investment Partnerships, Emergency Shelter Grants, and Community Development Block Grants (CDBG).

#### Supplemental Disaster Funds:

The Supplemental Appropriations passed late last year allocated \$11.5 billion to HUD's Community Development Fund for reconstruction efforts and \$390 million to the Tenant Based Rental Assistance Fund. The latest Supplemental, currently under consideration, contains billions more to be appropriated to HUD for disaster assistance efforts. In addition, FEMA initially provided \$79 million in funding to HUD for the Katrina Disaster Housing Assistance Program to help in relocating evacuee families. All told, HUD is now, and will be, receiving billions of dollars in new funding that will need strong monitoring and oversight.

### HUD OIG oversight of post 9-11 efforts:

The HUD Office of Inspector General's response to the Gulf States affected by Hurricanes Katrina, Rita and Wilma was immediate and institutionalized based on lessons learned from our in-depth experience with the aftermath of the events of September 11, 2001. The Congress appropriated \$3.5 billion in CDBG grants for New York and required that we semiannually audit and report on the expenditure of those funds.

We learned from our 9-11 efforts that to be effective, your teams on the ground, and at headquarters, must be proactive rather than reactive. Although a basic concept, it is one that is key to the ability to make a real impact. This proactive posture extends to collaboration. Rebuilding and redevelopment must happen cooperatively with state agencies that know their communities and citizens needs.

Inspectors General and law enforcement officials know they cannot prevent waste, fraud and abuse alone. Joint Task Forces combine agencies' assets, manpower, information technology, budgets, and other agency specialties to monitor expenditures and attack fraudulent and criminal activities.

To be truly effective you must continuously work to prevent waste, fraud, and abuse and must act in real time to have a deterrent impact and we hope to have additional resources so that we can have that effect. Some of the best practices we garnered from our experiences have become invaluable to us in this current effort, such as:

- Criminal investigators and auditors training state and local entities on how to uncover fraud, how to identify fraud indicators, how to retain necessary documentation, and how to make referrals to appropriate law enforcement;

- Participating in joint teams, such as grant fraud working groups and construction integrity teams;
- Setting up hotlines and information campaigns on how to report fraud; and
- Properly vetting contractors and subcontractors and creating a clearinghouse database, as well as systems to conduct employee background checks.

The essential reason why fraud and abuse is lessened in the lower Manhattan redevelopment programs is tied to Congress' requirement that HUD OIG engage in continuous proactive auditing and regular reporting of its results. Consequently, accountability was established early and the responsible use of tax dollars was ensured. With this added responsibility, however, Congress must ensure we have the resources to adequately undertake this new and labor-intensive mission. We are five years out from 9-11 and we are still dedicating audit and investigation resources to OIG activities there.

However, it is also important to understand the differences that exist between 9-11 and the Gulf Coast hurricanes ("Katrina").

From a reconstruction or rebuilding stance, Katrina is different from our 9-11 experience. With 9-11 there were only two major "pass through" entities (the Empire State Development Corporation and its subsidiary, the Lower Manhattan Development Corporation); there were fewer prospective grantees and subgrantees; there was a limited land area to consider; and the oversight activities were, therefore, more controllable. In all of these aspects, the Katrina disaster differs and, thus, makes oversight a much more arduous task.

### The Housing Authority of New Orleans:

In addition to the influx of new Katrina funding, as stated above, the Department and HUD OIG must deal with a pre-existing, heavy New Orleans audit and investigative workload. Prior to Katrina, the Housing Authority of New Orleans (HANO) was in Receivership and under HUD's control after a long stint on HUD's "troubled" housing authority list. HANO had long been known as crime-ridden and plagued with mismanagement in the administration of its daily operations. Close cooperation will need to continue with the HUD OIG, the U.S. Attorney's Office and the Department regarding this housing authority.

HUD will be consumed with the job of resurrecting the devastated HANO. Contracts and expenditures that occurred pre-Katrina must still be audited and analyzed. The administration and disposition of previously appropriated funds must still be accounted for as well as the added emergency uses and the new disaster funding.

### HUD OIG Concerns:

The new Congressional funding, grants in aid and CDBG money, will add to the opportunity of persons bent on defrauding the government and its rebuilding activities. We know from our past experiences that rehabilitation and reconstruction contracts set up with loose requirements are at greater risk for fraud and that the sheer volume of transactions here will provide a rich environment.

We believe that we may encounter various types of criminal vulnerabilities, such as:

- False Statements and Claims
- Theft or Bribery

- Tax Evasion
- Artificial Price Market Inflation
- Contract Fraud: Invoicing and Double Billing
- Embezzlement
- Bid Rigging
- Insurance Fraud
- Environmental Crimes
- Public Corruption
- False Payrolls
- False Appraisals
- Collusion; and
- Kickbacks

We believe our oversight will show that the most effective way to proceed is that monitoring be constant, continuous and at all the different levels of activity. Monitors should be concerned with the funds disbursement from the U.S. Treasury to state financial institutions; disbursements from the states to the subgrantees; invoices and paperwork of the grantees and subgrantees; quarterly reports for award and expenses; and quarterly reports on fraud prevention.

Due to the size and scope of the devastation, the Congress has involved the states in the oversight and auditing of federal grant money to homeowners affected by Katrina. To accomplish this activity, states have drawn up action plans on how to administer and monitor federal grant monies.

The first state to submit their plan was the state of Mississippi through their agency, the Mississippi Development Authority (MDA). The MDA met on several occasions with the HUD Office of Inspector General to discuss their plan and to be briefed by our officials on the potential for scams and how to deal with application fraud, such as, false statements, identity theft and false

documents. In addition, as part of our education efforts, the HUD OIG also briefed MDA contract appraisers hired to assess property damage on fraud. Also, homeowners applying for grant money will receive a HUD OIG fraud awareness bulletin as part of their grant application package.

While we are all working together to put controls in place we do, however, still have some concerns. From an audit oversight standpoint, according to the MDA plan, oversight and monitoring of grant funds ceases after the state has issued “compensation” funds to the homeowner “to be used at the discretion of the homeowner.”

The MDA plan is concerned with the funds to the point when they are given to the homeowner, at which point they are allowed to work through their personal disaster recovery as they see fit. We do not think that monitoring and oversight should end at this phase and we have remaining concerns about how a “compensation” plan that basically reimburses will spur the rebuilding of now blighted communities. What is to become of these communities in the future?

I can assure the Committee today that our monitoring plan intends to focus, to the greatest extent possible, on the ultimate disposition of the use of funds, the accountability by the state in issuing the funds and the homeowner’s responsible use of the funds for their intended purpose – disaster relief, long-term recovery of communities, including the rebuilding of houses, and restoration of area’s infrastructure.

There are also continuing problems with the execution of data matching among federal agencies. Our counsel is finalizing a protocol with FEMA in order to use their data for matching purposes but we have encountered roadblocks along the way.

The problems that we have encountered would be greatly mitigated if the Privacy Act included an exception for post-disaster data matching, or if alternative legislation – perhaps as a supplement to the Stafford Act – required federal agencies to engage in data matching as a routine procedure in their provision of disaster assistance.

#### Office of Audit Activities:

My Office of Audit established an office for Hurricane Katrina oversight immediately after the disaster to prepare for the long process of recovery. Concurrently, an audit plan was developed and reviews in the disaster areas begun.

Initially, the Office reviewed all HUD waivers to assure that statutory requirements were not waived. They are currently evaluating HUD's use of real estate owned (REO) properties to house disaster evacuees and auditing has commenced on HUD's actions in awarding \$17 million in contracts issued for disaster-related activities. The timely nature of these reviews will establish our presence and act as a real-time deterrent to waste and abuse in HUD's activities.

In addition, the Office is also auditing management and marketing contractors in two separate states.

Moreover, we have identified PHAs providing Katrina Disaster Housing Assistance Program (KDHP) vouchers with a plan to audit this process/matching review, and are monitoring HUD contracting efforts relating to disaster recovery efforts as part of the U.S. Department of Health and Human Services (HHS) Contract Oversight Task Force.

#### Office of Investigation Activities:

My Office of Investigation established the Hurricane Katrina Fraud Task Force (task force) to deal with HUD law enforcement issues. This task force works jointly with the Federal Bureau of Investigation (FBI), the U.S. Department of Justice (DOJ) Command Center in Baton Rouge, LA and State investigative agencies to investigate fraud in all HUD programs affected by the hurricanes in the Gulf. The task force is based in New Orleans with our personnel also assigned in Arlington and Houston, TX; Baton Rouge, LA; and Hattiesburg, MS.

The Office of Investigation has created a far-reaching fraud prevention program designed to: (1) create a training course for agents/auditors and program officials to teach them to identify fraud in CPD/grant programs; (2) sponsor fraud prevention meetings between HUD OIG and the major programs of HUD; and (3) sponsor fraud prevention meetings between HUD OIG and industry groups, such as the Mortgage Bankers Association; private insurance companies; the Public Housing Authorities Directors Association; the National Association Housing and Redevelopment Officials; multifamily owners; public housing executive directors; State governments; and economic development agencies.

As part of our fraud prevention program, HUD OIG has created a Suspicious Activity Report (SAR) that will be given to HUD grantees, subgrantees, and others associated with delivering disaster funds. As you can from the exhibit, the SAR is a method of informing HUD OIG of suspected irregularities in the delivery of HUD program money.

At this juncture, HUD Office of Investigation has opened 24 cases for the period ending April 27, 2006, which has resulted in six indictments, six arrests, and two convictions.

In closing, I would like to thank the Subcommittee for the opportunity to talk about the tremendous work that the agents, auditors, attorneys and support people of the HUD Office of Inspector General have accomplished since the onset of this tragic and trying event. Our people do it because we are committed to the Department's mission of providing safe, decent, sanitary and affordable housing for the Nation, and of providing economic development for our country's communities.